

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
AT RICHMOND, MAY 30, 2006

APPLICATION OF

APPALACHIAN POWER COMPANY

CASE NO. PUE-2006-00065

For an increase in electric rates

ORDER FOR NOTICE AND
HEARING AND SUSPENDING RATES

Pursuant to Va. Code § 56-582 C, an incumbent electric utility providing service under capped rates, as established and adjusted in accordance with Va. Code §§ 56-582 A and B, may, under certain conditions, petition the State Corporation Commission ("Commission") for approval of a one-time change in its rates. Any such petition for a change to capped rates filed pursuant to Va. Code § 56-582 C shall be governed by the provisions of Chapter 10 (§ 56-232 et seq.) of Title 56 of the Code of Virginia ("Chapter 10").

On May 4, 2006, pursuant to Va. Code § 56-582, Chapter 10, and the Rules Governing Utility Rate Increase Applications and Annual Informational Filings, 20 VAC 5-200-30 ("Rate Case Rules"), Appalachian Power Company ("APCo" or the "Company") filed with the Commission an application, with accompanying testimony and exhibits, for an increase in base rates to be partially offset by a fuel factor rate credit to reflect a portion of off-system sales ("OSS") margins until those margins are reflected in the Company's next fuel proceeding ("Application").

According to APCo, the Application demonstrates the need for an increase in the Company's base rates in the amount of \$225.8 million, partially offset by a \$27.3 million fuel factor rate credit, resulting in a net increase of \$198.5 million in charges to customers. The base rate increase is derived from pro-forma revenues of \$1.2 billion, pro-forma expenses of \$1.0

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billion, and a pro-forma rate base of \$42.3 billion. This proposed revenue requirement reflects a rate of return on rate base of 8.211%, based on a rate of return on common equity of 11.5% and a projected capital structure for APCo as of September 30, 2007. The Company proposes to collect the \$225.8 million additional revenue requirement through changes to base rates effective June 3, 2006, or upon expiration of such suspension period as the Commission may order.

APCo proposes that future OSS margins no longer be included in the calculation of base rates, but instead be used to offset fuel costs in the Company's annual fuel factor adjustments pursuant to Va. Code § 56-249.6 D 1. Formerly, a representative level of OSS margins was reflected in base rates by crediting OSS margins to cost-of-service. In its Application, APCo proposes that the level of OSS margins that the Company achieves each year be shared between customers and the Company, 40% and 60%, respectively. According to APCo, this proposal is designed to give the Company an incentive to maximize OSS margin levels by balancing the risks and rewards now associated with OSS margins between customers and the Company. The \$27.3 million credit is proposed to become effective simultaneously with the proposed base rate increase.

The Company indicates that the base rates proposed seek additional revenues to collect costs for environmental compliance and system reliability ("E&R costs") expected to be incurred on a going forward basis. APCo states that the E&R costs sought in the instant proceeding are not duplicative of the Company's request in Case No. PUE-2005-00056, Application of Appalachian Power Company, For adjustment to capped electric rates pursuant to § 56-582 B (vi) of the Code of Virginia, for recovery pursuant to Va. Code § 56-582 B (vi) of the costs associated with compliance with state and federal environmental laws and regulations and transmission and distribution system reliability incurred during the period July 1, 2004, through September 30, 2005.

NOW THE COMMISSION, upon consideration of the Application and applicable statutes and rules, is of the opinion that this matter should be docketed and that the proposed increase in rates, charges, and terms and conditions of service should be suspended, pursuant to Va. Code § 56-238, for a period of one hundred fifty (150) days from the date the Application was filed with the Commission to and through October 1, 2006. The proposed rates, charges, and terms and conditions of service should take effect for service rendered on and after October 2, 2006, on an interim basis subject to refund with interest. We find that a public hearing should be convened to receive evidence on the Application, that APCo should be directed to give notice to the public of its Application, and that a procedural schedule should be established herein. A Hearing Examiner will be appointed to conduct further proceedings on behalf of the Commission and to file a final report and recommendation.

We note that Case No. PUE-2005-00056 is currently pending before the Chief Hearing Examiner. A ruling by the Commission in that case may affect the Company's rates during the suspension period and as effective on an interim basis thereafter. The Application is silent on how any change in base rates associated with the E&R costs at issue in Case No. PUE-2005-00056 should be treated for purposes of the instant proceeding. At such time as the Commission enters a ruling in Case No. PUE-2005-00056, comment may be sought on how any change in the Company's rates resulting from that case should be reflected herein.

Accordingly, IT IS ORDERED THAT:

- (1) This matter is hereby docketed and assigned Case No. PUE-2006-00065.
- (2) The proposed increase in rates, charges, and terms and conditions of service shall be suspended, pursuant to Va. Code § 56-238, for a period of one hundred fifty (150) days from the date the Application was filed with the Commission to and through October 1, 2006. The

proposed rates, charges, and terms and conditions of service shall take effect for service rendered on and after October 2, 2006, on an interim basis subject to refund with interest.

(3) A public hearing shall be convened before a Hearing Examiner on November 7, 2006, at 10:00 a.m., in the Commission's Courtroom, Second Floor, Tyler Building, 1300 East Main Street, Richmond, Virginia, to receive comments from members of the public and to receive evidence on the Application. Any person not participating in this proceeding as a respondent as provided for herein may give oral testimony concerning the Application as a public witness at the November 7, 2006, hearing. Public witnesses desiring to make statements at the hearing need only appear in Commission's Courtroom prior to 9:45 a.m., on the day of the hearing and register a request to speak with the Commission's bailiff.

(4) As provided by § 12.1-31 of the Code of Virginia and pursuant to 5 VAC 5-20-120 of the Commission's Rules of Practice and Procedure, 5 VAC 5-20-10 et seq. ("Rules of Practice and Procedure"), this matter is hereby assigned to a Hearing Examiner to conduct further proceedings herein on behalf of the Commission and to file a final report and recommendation.

(5) The Company shall make copies of the Application as well as a copy of this Order, available for public inspection during regular business hours at each of the Company's business offices in the Commonwealth of Virginia. Copies also may be obtained by submitting a written request to counsel for the Company, Anthony Gambardella, Esquire, Woods Rogers PLC, 823 East Main Street, Suite 1200, Richmond, Virginia 23219. If acceptable to the requesting party, the Company may provide the Application by electronic means. Copies of the Application, testimony, and schedules, as well as a copy of this Order, also shall be available for interested persons to review in the Commission's Document Control Center, located on the First Floor of the Tyler Building, 1300 East Main Street, Richmond, Virginia. between the hours of

8:15 a.m. and 5:00 p.m., Monday through Friday. Interested persons may also download unofficial copies from the Commission's website: <http://www.scc.virginia.gov/caseinfo.htm>.

(6) On or before June 30, 2006, the Company shall file with the Clerk of the Commission an original and fifteen (15) copies of any additional direct testimony, exhibits, and other material supporting the Application.

(7) On or before July 7, 2006, the Company shall cause the following notice to be published as display advertising (not classified) in newspapers of general circulation throughout the Company's service territory within the Commonwealth of Virginia:

NOTICE OF THE APPLICATION BY
APPALACHIAN POWER COMPANY
FOR AN INCREASE IN ELECTRIC RATES
CASE NO. PUE-2006-00065

On May 4, 2006, pursuant to Va. Code § 56-582, Chapter 10 (§ 56-232 *et seq.*) of Title 56 of the Code of Virginia ("Chapter 10"), and the Rules Governing Utility Rate Increase Applications and Annual Informational Filings, 20 VAC 5-200-30, Appalachian Power Company ("APCo" or the "Company") filed with the State Corporation Commission ("Commission") an application, testimony, and exhibits for an increase in base rates to be partially offset by a fuel factor rate credit to reflect a portion of off-system sales ("OSS") margins ("Application"). Pursuant to Va. Code § 56-582 C, an incumbent electric utility providing service under capped rates may, under certain conditions, petition the Commission for approval of a one-time change in its rates.

According to APCo, the Application demonstrates the need for an increase in the Company's base rates in the amount of \$225.8 million, partially offset by a \$27.3 million fuel factor rate credit, resulting in a net increase of \$198.5 million in charges to customers. The base rate increase is derived from pro-forma revenues of \$1.2 billion, pro-forma expenses of \$1.0 billion, and a pro-forma rate base of \$42.3 billion. This proposed revenue requirement reflects a rate of return on rate base of 8.211%, based on a rate of return on common equity of 11.5% and a projected capital structure for APCo as of September 30, 2007.

APCo proposes that future OSS margins no longer be included in the calculation of base rates, but instead be used to offset fuel costs in the Company's annual fuel factor adjustments

pursuant to Va. Code § 56-249.6 D 1. Formerly, a representative level of OSS margins was reflected in base rates by crediting OSS margins to cost-of-service. In its Application, APCo proposes that the level of OSS margins that the Company achieves each year be shared between customers and the Company, 40% and 60%, respectively. According to APCo, this proposal is designed to give the Company an incentive to maximize OSS margin levels by balancing the risks and rewards now associated with OSS margins between customers and the Company. The \$27.3 million credit is proposed to become effective simultaneously with the proposed base rate increase.

The Company indicates that the base rates proposed seek additional revenues to collect costs for environmental compliance and system reliability ("E&R costs") expected to be incurred on a going forward basis. APCo states that the E&R costs sought in the instant proceeding are not duplicative of the Company's request in Case No. PUE-2005-00056, Application of Appalachian Power Company, For adjustment to capped electric rates pursuant to § 56-582 B (vi) of the Code of Virginia, for recovery pursuant to Va. Code § 56-582 B (vi) of the costs associated with compliance with state and federal environmental laws and regulations and transmission and distribution system reliability incurred during the period July 1, 2004, through September 30, 2005.

Copies of the Application and the Commission's Order for Notice and Hearing are available for public inspection during regular business hours at each of the Company's business offices. Copies also may be obtained by submitting a written request to counsel for the Company, Anthony Gambardella, Esquire, Woods Rogers PLC, 823 East Main Street, Suite 1200, Richmond, Virginia 23219. Copies also are available for interested persons to review in the Commission's Document Control Center, located on the First Floor of the Tyler Building, 1300 East Main Street, Richmond, Virginia between the hours of 8:15 a.m. and 5:00 p.m., Monday through Friday. Interested persons may also download unofficial copies from the Commission's website: <http://www.scc.virginia.gov/caseinfo.htm>

The Commission has suspended the Company's proposed increase, pursuant to Va. Code § 56-238, for a period of one hundred fifty(150) days from the date the Application was filed with the Commission to and through October 1, 2006. The proposed rates, charges, and terms and conditions of service shall take effect for service rendered on and after October 2, 2006, on an interim basis subject to refund with interest.

The Commission has scheduled a public hearing for November 7, 2006, at 10:00 a.m., in the Commission's Courtroom, Second Floor, Tyler Building, 1300 East Main Street, Richmond, Virginia, to receive comments from members of the public and to receive evidence on the Application.

On or before August 7, 2006, any interested person may file written comments on the Application by filing an original and fifteen (15) copies of such comments with Joel H. Peck, Clerk, State Corporation Commission, Document Control Center, P.O. Box 2118, Richmond, Virginia 23218-2118. Interested persons may submit comments electronically by following the instructions found on the Commission's website:

<http://www.scc.virginia.gov/caseinfo.htm>. Any person not participating as a respondent as provided below, but desiring to make a statement at the November 6, 2006, public hearing concerning the Application as a public witness shall appear in the Commission's Second Floor Courtroom, Tyler Building, 1300 East Main Street, Richmond, Virginia prior to 9:45 am on the day of the hearing and sign up to speak.

Any interested person may participate as a respondent in this proceeding by filing, on or before August 7, 2006, an original and fifteen (15) copies of a notice of participation as a respondent with the Clerk of the Commission at the address set forth above. Pursuant to Rule 5 VAC 5-20-80 of the Rules of Practice and Procedure, any notice of participation shall set forth (i) a precise statement of the interest of the respondent; (ii) a statement of the specific action sought to the extent then known; and (iii) the factual and legal basis for the action. A person participating as a respondent must file with the Clerk of the Commission on or before September 1, 2006, at the address set forth above an original and fifteen (15) copies of any testimony and exhibits by which the respondent expects to establish its case. Interested persons should obtain a copy of the Commission's Order Notice and Hearing for further details on participation as a respondent.

All comments and notices of participation filed with the Clerk of the Commission shall refer to Case No. PUE-2006-00065 and shall simultaneously be served on counsel for the Company at the address set forth above.

APPALACHIAN POWER COMPANY

- (8) On or before July 7, 2006, the Company shall serve a copy of this Order on the chairman of the board of supervisors and county attorney of each county and upon the mayor or

manager of every city and town (or upon equivalent officials in counties, towns and cities having alternate forms of government) in which the Company provides service in the Commonwealth of Virginia. Service shall be made by first-class mail to the customary place of business or residence of the person served.

(9) On or before August 1, 2006, the Company shall file with the Clerk of the Commission proof of the notice and service required by Ordering Paragraphs (7) and (8) herein.

(10) On or before August 7, 2006, any interested person may file written comments on the Application by filing an original and fifteen (15) copies of such comments with Joel H. Peck, Clerk, State Corporation Commission, Document Control Center, P.O. Box 2118, Richmond, Virginia 23218-2118. Interested parties shall refer in their comments to Case No. PUE-2006-00065. Interested persons may submit comments electronically by following the instructions found on the Commission's website: <http://www.scc.virginia.gov/caseinfo.htm>.

(11) Any interested person may participate as a respondent in this proceeding by filing, on or before August 7, 2006, an original and fifteen (15) copies of a notice of participation as a respondent with the Clerk of the Commission at the address set forth in Ordering Paragraph (10) above and shall simultaneously serve a copy of the notice of participation on counsel to the Company at the address set forth in Ordering Paragraph (5) above. Pursuant to Rule 5 VAC 5-20-80 of the Rules of Practice and Procedure, any notice of participation shall set forth (i) a precise statement of the interest of the respondent; (ii) a statement of the specific action sought to the extent then known; and (iii) the factual and legal basis for the action. Respondents shall refer in all of their filed papers to Case No. PUE-2006-00065. Within five (5) business days of receipt of a notice of participation as a respondent, the Company shall serve upon each respondent a copy of this Order, a copy of the Application, and all materials filed with the Commission, unless these materials have already been provided to the respondent.

(12) On or before September 1, 2006, each respondent may file with the Clerk of the Commission at the address set forth in Ordering Paragraph (10) above an original and fifteen (15) copies of any testimony and exhibits by which the respondent expects to establish its case. Each respondent shall serve copies of the testimony and exhibits on counsel to the Company, all other respondents, and the Commission Staff.

(13) On or before October 4, 2006, the Commission Staff shall investigate the Application and shall file with the Clerk of the Commission an original and fifteen (15) copies of testimony and exhibits regarding its investigation and shall promptly serve a copy on counsel to the Company and all respondents.

(14) On or before October 19, 2006, the Company shall file with the Clerk of the Commission an original and fifteen (15) copies of any rebuttal testimony that the Company expects to offer in rebuttal to the testimony and exhibits of the respondents and the Commission Staff and shall on the same day serve one copy on the Commission Staff and all respondents.

(15) The Company and respondents shall respond to written interrogatories within ten (10) calendar days after receipt of the same. Except as modified herein, discovery shall be in accordance with Part IV of the Rules of Practice and Procedure.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to:
Anthony Gambardella, Esquire, Woods Rogers PLC, 823 East Main Street, Suite 1200,
Richmond, Virginia 23219; Guy T. Tripp III, Hunton & Williams LLP, 951 East Byrd Street;
Richmond, Virginia 23219; James R. Bacha, Esquire, American Electric Power Service
Corporation, 1 Riverside Plaza, Columbus, Ohio 43215; C. Meade Browder, Jr., Senior Assistant
Attorney General, Division of Consumer Counsel, Office of Attorney General, 900 East Main
Street, Second Floor, Richmond, Virginia 23219; and the Commission's Office of General

Counsel and Divisions of Energy Regulation, Economics and Finance, and Public Utility
Accounting.